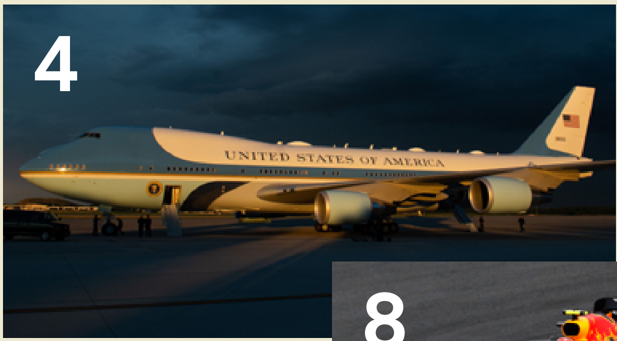
Vontobel

# Investors' Outlook

## Air Force One has a new captain

November 2020

# Content



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# Air Force One has a new captain

—
**Dan Scott**
Chief Investment Officer,
Head of Investments & Thematics,
Vontobel

Dear readers,

After a lifetime of personal setbacks and a patient ascent to the top, Joe Biden's time has finally come. Nicknamed "Amtrak Joe" for his decade-long railway commute between his home in Wilmington, Delaware, to Washington DC, he will now switch to the more glamorous presidential plane Air Force One.

**Biden win paves the way for stimulus measures**
However, the wave of popular support that pushed open the doors of the White House for Joe Biden stopped in front of Capitol Hill. Hopes that his Democratic Party would retake the majority in the US Senate, using it alongside its grip on the House of Representatives to form a formidable legislative force, were dashed – the two chambers of US Congress will remain split along "red" and "blue" party lines.

Still, with Mr. Biden now at the helm, the Democrats increase their clout, which will probably enable them to pass modest policy changes. Donald Trump is now gone but his tax cuts will probably remain in place. We can now also expect economic stimulus measures, aimed at supporting those affected by the Covid-19 pandemic. Improved US relations with the rest of the world – with fewer sanctions and lower trade tariffs – is another likely and welcomed consequence of Mr. Biden moving into the Oval Office early next year. Financial markets may have qualms about the Democrats' regulatory bias, but should appreciate friendlier trade relations. And please keep in mind that the support we currently receive from central banks is what matters most for the markets, there is no change there.

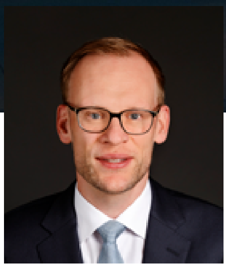
**Covid-19 refuses to go away**
Meanwhile, a second wave of the pandemic is sweeping across the globe. In Germany, a new nationwide lockdown has been imposed with bars, restaurants and entertainment venues being closed. French restrictions are even stricter given the closure of non-essential shops and a stay-at-home order. The danger of a new wave of full-blown lockdowns all over Europe is increasing with each passing day. Night-time curfews in Italy and Spain are also in place and stricter measures envisaged – if needed. Most governments try to prevent such a drastic measure at all costs, but the lighter measures imposed now might not be enough to tame the raging pandemic.

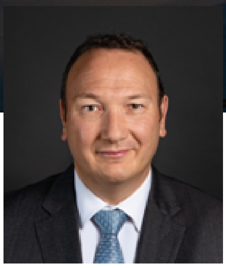
The economic outlook is, therefore, far more uncertain now than in March, and we forecast the global economy to contract 4.2% this year. The International Monetary Fund has already warned that a long, uneven and uncertain recovery lies ahead. Most countries won't be able to bounce back to pre-pandemic levels already next year, with the notable exception of China. Recent figures indicate that Chinese growth already exceeds pre-Covid levels, boosted by both industrial production and its consumers opening their wallets. The picture is not as rosy in Europe. Not only is the EU grappling with the negative economic impact of Covid-19. The trade bloc is simultaneously embroiled in never-ending Brexit talks. The outcome of the negotiations is still unclear less than two months before the current transition phase ends on December 31, 2020.

**May the (Air) Force be with him**
To end on a positive note: In the US, Joe Biden's victory is a breath of fresh air for the US economy, set to be buoyed by fiscal stimulus measures getting the country back on track and fostering a transition from a fossil fuel economy to a renewable one. We congratulate Joe Biden on this historic moment and hope he can bring his nation closer together again. May the (Air) Force be with him.

**⟶ Webcast**
To view Dan Scott's webcast on recent market developments, click:
**vonto.be/macro-en-nov20**

**Please be aware that the video link will be live in the course of November 10.**



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# A steady hand in turbulent times: we stick with our equities overweight

Autumn is the season of crisp breezes and spectacular views. Not so much for investors, though, whose vision is impaired by the pandemic and US elections. Despite some thickening fog, we are trying to chart a steady course. Our asset allocation hasn't changed much over the past few months, and we still favor equities, although it is increasingly hard to make out the cliffs in the distance.

Now that Joe Biden looks set to move into the White House, what are the consequences for Wall Street and beyond?

Market participants generally hate change and mistrust a Democrat administration for its supposed love of higher taxes and strict regulation. Therefore, Joe Biden's victory will send a few alarm bells ringing in Lower Manhattan. At the same time, many executives tired of Donald Trump's unpredictability – regarding China, for instance – will breathe a sigh of relief. What's more, the flood of central bank-generated liquidity, still-attractive valuations of stocks compared to those of bonds, and the ongoing if shaky economic recovery are likely to improve market sentiment over a nine to 12-month horizon.

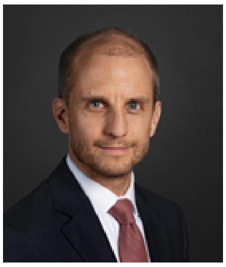
Before taking the Oath of Office next January, the president-elect may face legal hurdles or downright chaos in parts of the country. Remember the US Supreme Court ruling that was necessary to decide a previous presidential race after the George W. Bush and Al Gore camps clashed over the Florida ballot. And that was 20 years ago, a time when the fabric of American society was still relatively intact. Moreover, what will happen if the pandemic gets out of control again, nipping an economic recovery in the bud? In a way, life seemed easier in March when the the economy had nowhere to go but up. That said, our base scenario remains "rehabilitation", and we continue to prefer equities to bonds. Read our allocation details in the table on page 5.

| | UNDERWEIGHT significantly | UNDERWEIGHT slightly | NEUTRAL | OVERWEIGHT slightly | OVERWEIGHT significantly | |
|---|---|---|---|---|---|---|
| **1 Liquidity** | | → | | | | Holding cash seems to make little sense when interest rates hover around zero and prospects of a rate hike are constantly being pushed further back. We retain our underweight stance. |
| **2 Bonds** | | → | | | | The low-rate conundrum applies to fixed income as well, and we retain our overall negative view. Within this asset class, we stick to our neutral stance both on high yield (HY) and government bonds. Our analysis shows that longer duration is a good diversifier, adds portfolio protection, and helps address higher short-term risks. Moreover, central banks' purchasing programs support segments such as government bonds. We maintain our negative stance on investment-grade issues given that their spreads versus HY have fallen below the lowest levels since February. This makes the risk-reward profile of that class rather unattractive. |
| **3 Equities** | | | | → | | Despite increased risks, equities remain an overweight. However, we downgrade Europe to negative from neutral due to pandemic worries, Brexit uncertainty and an underdeveloped technology sector. By contrast, we lift our already positive stance on emerging economies by a notch to strongly positive. Apart from managing the pandemic better, heavyweights like China, South Korea, and Taiwan display a more attractive risk-reward profile than any other (developed) market. We retain our positive stance on other regions such as the US, Japan and Switzerland on the back of their attractive valuation, technical trends, earnings momentum and quality. |
| **4 Gold** | | | | | → | Precious metals remain a strong overweight in our eyes. While inflation should remain contained in the medium term, it could become a worry if governments and central banks continue to resort to printing money. Moreover, the US dollar's weakness alongside limited gold supply should keep supporting prices. |
| **5 Commodities** | | | → | | | Commodities have performed well since late spring, benefiting from the global economic recovery after the end of strict lockdowns. However, it would be premature to go overweight in this asset class. We stick with our neutral rating. |
| **6 Alternative strategies** | | → | | | | We retain our underweight on hedge funds and a neutral view on insurance-linked securities (ILS). They served as a cushion in times of high volatility. After the central banks managed to calm financial markets, the need for such a backstop decreased. |

Changes month-on-month: same → higher ↗ lower ↘

# Economic rebound at risk due to new restrictions in Europe and the US fiscal cliff

**After taking a summer break, the virus has returned in the fall, and the resulting restrictions put a continued economic recovery at risk in Europe and the US. There, the size and timing of a new fiscal relief package for American households remain unclear even after the election fog has lifted. At the same time, most Asian countries and particularly China appear to be able to contain the virus better, and are becoming mainstays of a global recovery.**

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Recent stellar growth numbers have confirmed the quick economic rebound in the third quarter from the pandemic-induced downturn earlier this year. That said, the economic performance is still nowhere near pre-Covid levels (see chart 1). While this would leave much room for further improvement in the last quarter, prospects of a continued rebound have darkened owing to another wave of Covid-19 in Europe and the US (see chart 2). The fear of a surging death toll has left European governments in a delicate situation – how to keep the pressure on healthcare systems manageable without shutting the whole economy down like in the spring.

Elsewhere, the new Covid-19 hotspots are some Latin American countries and Russia. Asian countries report a decreasing number of infections and look set to remain drivers of the global economic rebound. According to our current outlook, Asian emerging markets, particularly China, should do well, supporting our view of an ongoing underlying economic recovery. This is contingent on a bearable level of government-imposed restrictions to prevent the spread of the coronavirus in Europe and the US.

**US growth holding up, Covid-19 still a threat**
"Flash" US GDP numbers have confirmed a post-lockdown economic rebound with third-quarter activity picking up by 33.1 % in annualized terms versus a slump of –31.4 % in the second quarter. Leading indicators such as purchasing manager surveys for October suggest the recovery held up at the beginning of the fourth quarter. The sentiment in the US services sector has improved modestly, and expectations regarding future business were markedly higher. However, most US states now witness a surge in daily new Covid-19 cases. Restrictions have stayed localized for the time being but the necessity of stricter measures would endanger the economic recovery in the same way that we observe in Europe.

While the election of Joe Biden as the next US president puts an end to political uncertainty, he will only take office on 20 January, 2021. One of the issues waiting to be solved is a much-needed new fiscal package to relieve the population's economic pain. As the US Congress looks set to remain split, fiscal support is likely to be smaller than in a «Democratic sweep» scenario, but could be approved sooner rather than later.

### Europe reeling from new restrictions and sinking feeling

After France and Germany have imposed new nationwide lockdowns to stave off Covid-19, the trend towards harsher restrictions is apparent. Although the measures are still not as wide-ranging in most countries as during the first wave at the time of writing, more restrictions and worsening consumer sentiment will probably transform the expected economic rebound into another dip in the fourth quarter. The new restrictions mostly apply to the hospitality sector, venues such as museums or cinemas, and other person-related services. By contrast, the industrial sector is less affected. This has resulted in another demand-led shock, which means price pressure should remain low overall. With this in mind, we expect the European Central Bank to prop up its asset-purchasing program during the monetary policy meeting in December to support the staggering economy.

While we still expect a transitory agreement between the UK and the European Union to cushion any negative economic impact during the Covid crisis, the negotiations seem stuck. However, with the change in the White House, Europe may hope that Washington will revert to traditionally warm relations with the allies on the old continent.

### Japan sentiment improving

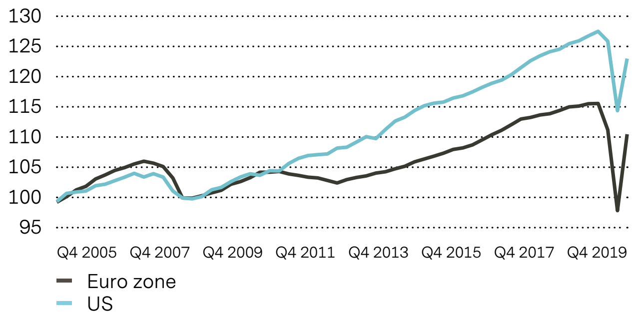
Rebounding exports to China and the US have helped the Japanese economy to a gradual recovery until September. Activity surveys and consumer confidence indicators continue to show improving trends, albeit at a moderate pace, confirming our expectations of a slow recovery from the pandemic. We expect Japan's GDP to slump by 5.3% in 2020 and to rise by 2.3% in 2021.

### Emerging markets powered by Asia and China

The economic recovery in emerging markets continues. However, we had to downgrade our forecasts of Chinese real GDP growth from 2.1% to 1.8%, as China's third-quarter GDP (+4.9% year-on-year) missed market expectations. Still, China leads the pack as one of the few countries expected to post positive growth rates in 2020. The reason for the third-quarter miss is that infrastructure investments – which are directly influenced by the government – lagged behind the development of other sectors like retail sales or industrial production (see chart 3). In our opinion, this indicates that Chinese authorities are relatively satisfied with the current pace of the economic recovery. Therefore, they hesitate to execute all planned infrastructure projects. Outside of Asia, the picture is much darker but there are a few green shoots. While growth in Latin America is in general slow, Brazil is an outlier with leading indicators pointing to a fast recovery in the second half of 2020. Generally, emerging economies will pin their hopes on a pro-trade stance of Joe Biden's administration, which will support their economic recovery.

**Chart 1: Despite a stellar 3Q rebound, the US and European economies are still far below pre-Covid levels**

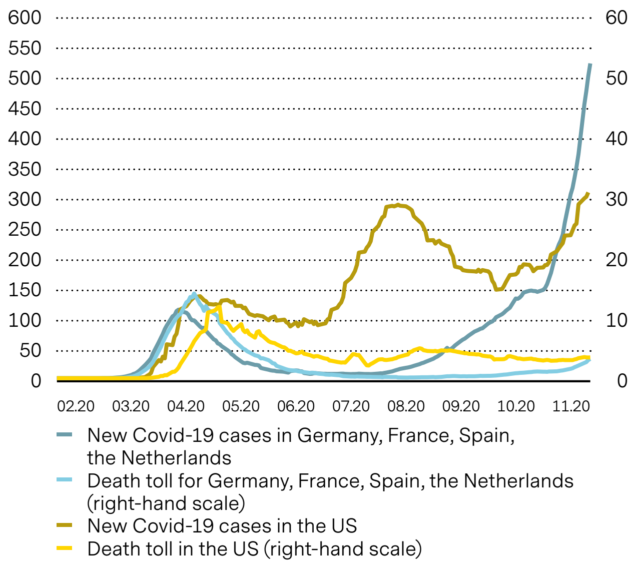
Index of real GDP
(weakest real GDP level after financial crisis, Q2 2009 = 100)




Source: Eurostat, Bureau of Economic Analysis, Refinitiv Datastream, Vontobel

**Chart 2: The number of fatalities trails that of new Covid-19 cases, but fears still run high**

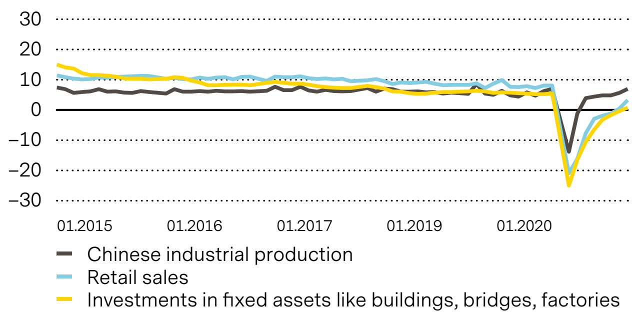
Covid-19 infections* Covid-19-linked casualties*




* Per 1 million inhabitants, five-day average (data as of 29.10.2020)
Source: World Health Organization, Refinitiv Datastream, Vontobel

**Chart 3: Industrial production boost China's economy but private consumption seems to be catching up**

Index




Source: China's statistical office, Refinitiv Datastream, Vontobel.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# Remember motor racing: emerging-market winners make global inroads

**Regardless of the outcome of the US presidential elections, emerging market stocks will remain a potential sweet spot. Many investors are aware of the hidden qualities of emerging-market champions. They may remember how, in the high-octane world of motor racing, South American drivers such as Juan Manuel Fangio or Ayrton Senna often roared past their Italian, English, or German rivals. In the world of financial markets, emerging-market companies have made similar inroads, often eclipsing formidable western competitors.**

The road from relative obscurity to global fame may require a little luck, but it is mostly down to hard work and getting the fundamentals right. Emerging-market companies need a bright business idea, visionary managers and a large domestic market to become western household names.

Just as talent scouts make a living by discovering and managing young racing drivers, in the financial sphere, portfolio managers try to do the same to construct a portfolio of stocks that will perform over the long term. While talent scouts often cannot explain their decision to hire a particular driver, the mtx team uses a highly disciplined approach.

**The winner takes it all – now more than ever**
To distinguish corporate leaders from laggards, our mtx specialist team uses a four-pillar "matrix" approach (hence the mtx acronym). The four elements are as follows:

- A company's ability to achieve a high return on invested capital (ROIC), and to improve it further
- A competitive advantage, i.e. a pole position within the industry
- An attractive valuation of the stock
- An effective management of environmental, social and governance (ESG) risks

Let's concentrate on the second element, a company's industry positioning. We have seen time and again that leading companies tend to preserve their pole position, and they have clearly done so during the pandemic.[1] Within the mtx team, we define industry leadership in terms of sustainable value creation. This is the amount of cash earned by a firm in excess of its cost of capital or opportunity cost, the so-called economic profit. Sustainable value creation has two dimensions, expressed in two questions:

- How big is a leading company's economic profit relative to industry peers in absolute terms?
- For how long can a leading company sustain excess economic profit?

Sustainable value creation is not an easy feat, because competitive forces and disruptive innovations, among other factors, are constantly driving returns towards their cost of capital, thereby eroding economic profit. The size and sustainability of a firm's competitive advantage is rarely stable. Therefore, a framework is necessary to systematically measure and monitor industry positioning.

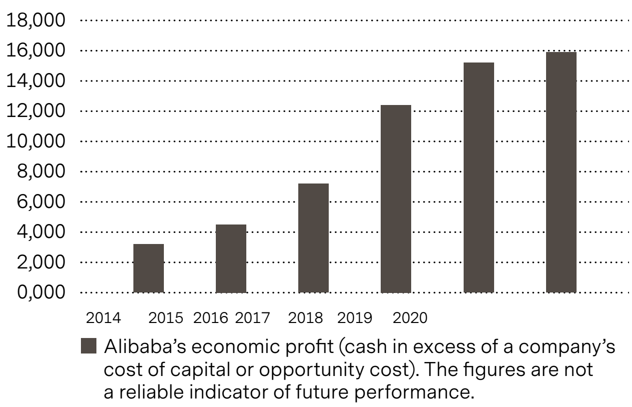
Whether or not a company can continue to thrive depends on many moving parts, such as specific challenges the industry faces as well as the company's innovative power or resilience to potential disruptions. To assess an industry's attractiveness, we evaluate economic profit pools. To judge industry stability, we use matrices tracking returns on investment (ROI). Looking at a company's profitability, we apply a lens of cost, price and external advantage. We identify and continuously track themes, including disruptive innovations, which grow or shrink the economic profit pool over time.

**Alibaba, an example of industry leadership**
Our research often guides us towards emerging-market champions that have become household names in the west, but sometimes also to less well-known ones. A prominent example is Alibaba, the Chinese e-commerce behemoth co-founded by a former English teacher, which capped its ascent to the rostrum by a massive initial public offering on Wall Street and a secondary listing in Hong Kong.

Alibaba's 100% online retail business model versus the global industry group average of 25% online revenue share has placed it in a favorable position to take advantage of the acceleration of the trend towards online shopping. The company has posted an impressive five-year compound annual growth rate of 37% in economic profit (see chart 1). While chart 1 highlights the steep rise in Alibaba's profits, it also shows a flattening of the curve, which our mtx team monitors closely.

**Rules-based approach works best**
Identifying potential winners is a particularly fascinating task in emerging markets, where identifying winners is difficult but all the more rewarding if you do it right. To avoid unexpected volatility, investors interested in emerging markets may want to rely on a fundamental, systematic and rules-based approach focused on leading companies. With a disciplined focus on higher-quality yet inexpensive stocks, they can achieve portfolio stability in an asset class that offers an attractive long-term risk-return profile. Naturally, emerging markets face specific challenges such as bouts of volatility, or the drag from the trade war. That's where the rubber hits the road. Similar to the race engineers on the pit wall setting the race strategy, our mtx investment team is focused on using objective information to make the right calls at the right time, to help emerging-market investors reach their own Grand Prix.

**Chart 1: Alibaba posts steep growth in economic profit**
Economic profit in USD millions




Source: Credit Suisse HOLT, Vontobel (data as of June 2020)

[1] The consultancy McKinsey states the following: "Between December 2018 and May 2020, the top quintile of companies grew its total market-implied annual economic profit by USD 335 billion, while companies in the bottom quintile lost a staggering USD 303 billion. And while the specific numbers can fluctuate from day to day, the larger trend is unmistakable: a gap is opening up, and it's rapidly expanding. That's a pattern that has been evident since 2010. Now, the COVID-19 pandemic is pushing it to entirely new levels."

# ECB to support the "periphery" throughout second Covid wave

—
**Sandrine Perret**
Senior Economist,
Fixed Income Strategist,
Vontobel

**In virus-hit Europe, bond spreads of "peripheral" countries could rise again on concerns that measures to contain the pandemic will depress economic activity. However, we believe that the European Central Bank's continued support through bond purchases and ample liquidity injections will protect this bond segment and prevent market stress, as was the case during the first Covid-19 wave.**

Peripheral government debt was one of the most volatile European assets during the market turmoil in March and April this year. When the Covid-19 pandemic hit Italy and then the rest of Europe in March, the spreads of southern European bonds widened massively versus German sovereigns, for example. This was due to the combined effect of falling growth expectations and higher domestic fiscal stimulus needed to support economies. The European Central Bank's (ECB) strong commitment to contain volatility as well as the launch of the Pandemic Emergency Purchase Programme (PEPP) were successful in easing stress in the European bond market. Spreads subsequently declined to close to pre-Covid levels during the summer as economies started to recover (see chart 1).

### Italy remains at risk

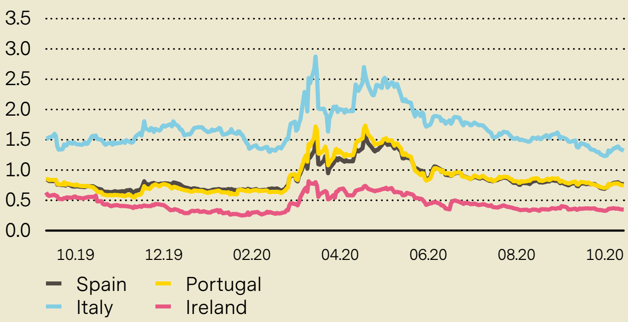
In light of the second wave of Covid hitting Europe strongly and posing risks to the economic recovery in the fourth quarter, ten-year bond spreads to Germany started moving higher in early October, especially in Italy (see chart 1). Despite the country's relative resilience to the second wave of the pandemic, its fiscal fragility puts it particularly at risk. The International Monetary Fund expects Italian debt to rise to 162% of GDP in 2020 from 135% in 2019 (see chart 2). That said, we don't expect investors to worry as long as the ECB lends a hand. Standard & Poor has also cited continued ECB support as a reason for its recent decision to revise Italy's sovereign rating up to a stable BBB from negative. Another factor for the S&P upgrade were the expected grants and loans for Italy under the European Union's recovery fund that are conditional on pro-growth reforms.

### ECB to cap yields as second Covid wave hits

Looking back at periods of bond market volatility in the euro zone, we expect ECB's firepower to prevail over short-term fiscal sustainability considerations one more time. Should a fast deterioration of the European economy require additional fiscal easing, the anticipation of ECB purchases alongside still ample liquidity to the banking sector will keep bond yields low across the board. This will be a key factor in putting economies on track for a recovery expected to take shape in 2021. Therefore, while peripheral spreads can fluctuate in the short term, the euro zone should be spared the threat of acute volatility it experienced during the first Covid-19 outbreak.

**Chart 1: ECB purchases of "periphery" bonds will ensure spreads stay low**

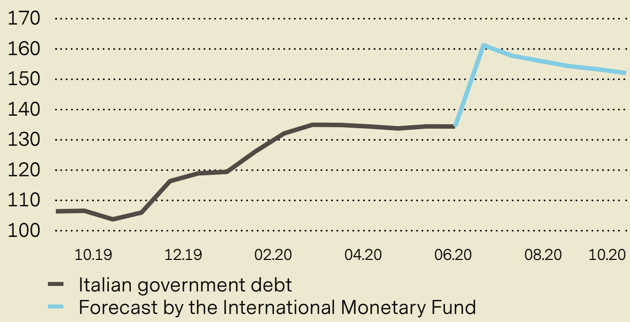
Ten-year periphery bond spreads to German benchmark in %




Source: Refinitiv Datastream, Vontobel

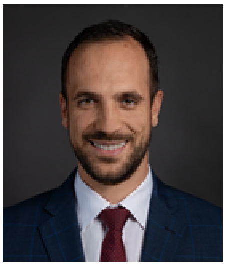
**Chart 2: Italian debt is expected to explode in 2020**

In % of GDP




Source: Refinitiv Datastream, IMF fiscal outlook (October 2020), Vontobel

# Emerging-market equities celebrate Joe Biden's victory



—
**Stefan Eppenberger**
Equity & Commodity Strategist,
Vontobel

**American politics and US financial markets make global headlines, but equity investors may be well-advised to follow a less obvious route. Emerging-market stocks are the secret stars of the pandemic. Asia's better virus control and the composition of emerging-market indices are the main reasons for this. Joe Biden's victory could boost this equity segment's prospects further.**

Emerging-market (EM) equities have long carried the "only good for risk takers" stigma. This view started to change before the spread of the coronavirus, but Covid-19 has accelerated the process. Part of this is down to performance. After suffering heavy losses during the 2008 financial crisis (see chart 1), the EM index compiled by MSCI comes third in 2020's list of year-to-date winners, only beaten by the tech-heavy US market and Switzerland's defensive blue-chip SMI. Other important markets such Japan and Europe follow far behind.

What has changed since the last major crisis? It is worth noting that despite originating in China, the Covid-19 virus devastated the "west" while leaving Asia relatively unscathed. Obviously, this was to large extent due to the successful measures that China, South Korea or Taiwan implemented to keep the pandemic at bay, which translated into better economic performance.

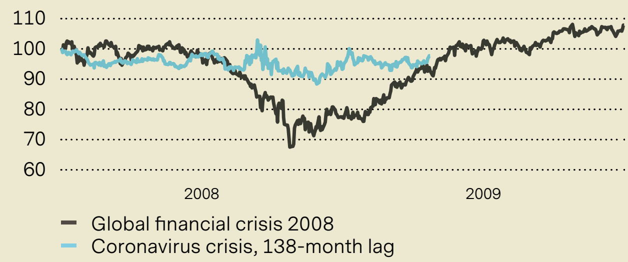
**A technology rite of passage**
Because companies from these three countries account for approximately two-thirds of the bellwether EM MSCI, the profits of the index constituents have been relatively resilient. Moreover, its robustness has improved owing to changes in sector composition. In 2008, state-owned companies such as Petrobras, Gazprom, and China Mobile, were the heavyweights in the index. Today, it is technology stocks such as Alibaba, Tencent, and Samsung that throw their weight around. For investors, this means less dependence on government-influenced business cycles, more exposure to private consumption and promising technology trends – and, by the way, to sectors with much better ESG credentials.

We have been sanguine about emerging-market equities since last September and have raised our position to "strong overweight" recently. In addition to the characteristics mentioned, we like the attractive valuation, especially in view of companies' profitability. Another reason for our confidence is our expectation that the US dollar will depreciate over the next few months, which has often benefited emerging-market equities.

Finally, Joe Biden's election should reduce the threat of an escalating US-Chinese trade war. The two periods of EM underperformance over the past five years have been a consequence of the disagreement between the world's two biggest economies (see chart 2). Therefore, the Biden administration is likely to improve relations and could clear the way for EM equities to outperform.

**Chart 1: A healthier composition of the EM index has made it more resilient between crises**

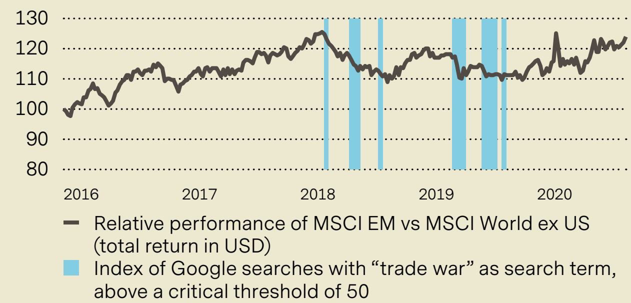
Index (rel. performance emerging markets versus developed markets*)




* Total return of MSCI EM vs MSCI World in USD
Source: Refinitiv Datastream, Vontobel

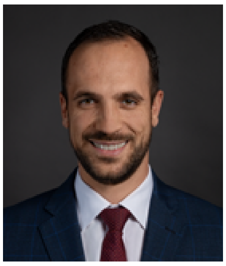
**Chart 2: An escalating US-Chinese trade war remains a risk for emerging-market equities**

Index (rel. performance emerging versus developed markets*)




Source: Google Trend, Refinitiv Datastream, Vontobel

# If you are worried about inflation, commodities could be right for you



—
**Stefan Eppenberger**
Equity & Commodity Strategist, Vontobel

**A commodity rally since the summer has caught the market's eye. Among the reasons are strong demand from China and the relatively low level of so-called rollover costs, i.e. the sale of an expiring futures contract and the simultaneous purchase of a new one. Investors worried about rising inflation could use commodities as a handy hedge.**

It takes some nerve to invest in commodities, not the least because the mining industry has drawn criticism from Greta Thunberg and other environment-conscious circles. Such scruples aside, many investors active in this asset class have lost money in the past few years (see chart 1). While commodities typically outperform equities in a major equity-market downturn, this rule of thumb hardly applies in times when financial markets are in a state of shock, or have just about recovered from the worst. However, since May, the commodity index has risen by more than 20% in absolute terms, in a similar order of magnitude as the global equity index.

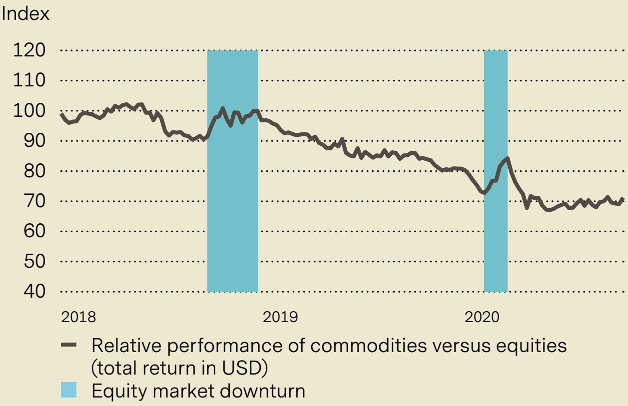
Have investors suddenly warmed to commodities? It is clear that the asset class has benefited from the global economic recovery since the end of the strict lockdowns this summer. Demand for the vast majority of commodities is highly cyclical, reflected in the close correlation between economic leading indicators and commodity prices in chart 2.

The main driver on the demand side is China, the most important destination of raw materials by far. China-bound shipments in all areas, from oil to industrial metals and grains, are going up, indicating that Chinese buyers try to benefit from cheap imports during an economic crisis.

Another reason for rising raw material prices are the restrictions on the supply side, such as lower US shale oil production since the outbreak of the health crisis. An increasing number of commodities are trading in so-called backwardation, i.e. a situation where spot prices are above forward prices. This should lead to significantly lower losses from rollover transactions in the future. This diminishes or even eliminates the so-called negative carry, a frequent worry for commodity investors. Therefore, commodity investments could become more attractive.

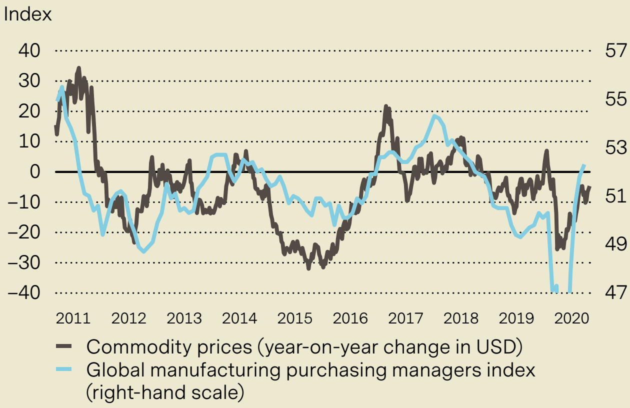
**We remain neutral**
We remain neutral in commodities, also because we expect the US dollar to weaken, a development that should support the asset class. However, commodities are likely to continue struggling against equities as long as inflation remains low. It is true that signals from central banks point to a greater tolerance of rising consumer prices. But given that the global economy is badly damaged, inflationary pressures are unlikely to be very strong in the short to medium term. Still, commodities are currently an attractive choice for early movers eager to hedge against inflation already now.

**Chart 1: Commodities have kept up with equities since the summer**




Source: Refinitiv Datastream, Vontobel

**Chart 2: Stronger economic growth, higher commodity prices**




Source: Refinitiv Datastream, Vontobel

# Currencies shrug off the second wave of the coronavirus

—
**Sven Schubert, PhD**
Head of Strategy Currencies,
Vontobel

**Currency markets typically reflect crises or important political events in real time. However, they remain unimpressed by the rise in Covid-19 new infections. Pound sterling, for its part, thumbed its nose at the Brexit gloom to become one of the strongest major currencies in October. We believe it has even more recovery potential.**

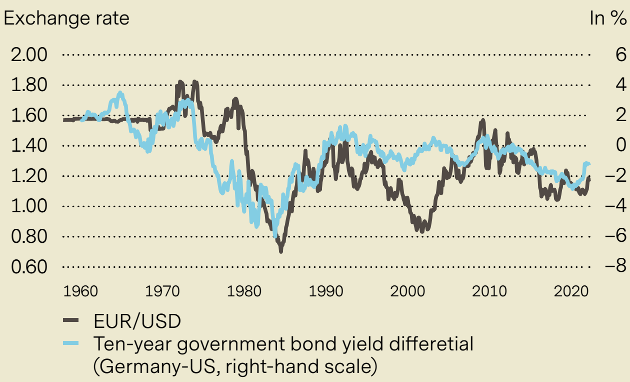
The euro, theoretically prone to wide swings given a nascent health crisis in Europe, held more or less steady. In the absence of severe lockdowns, we believe that the downside of the euro will be limited during the second Covid-19 wave. We see even upside potential for European currencies against the US dollar in the aftermath of the US elections, which may lead to short-term market volatility.

**Swiss franc seen up alongside the euro**
Medium to longer-term, the fundamental picture (see chart 1) still suggests the dollar will weaken against most major currencies. The US Federal Reserve's pledge to keep interest rates at historical low levels in the next few years should limit any rise of US yields, in particular on a relative basis against other countries. Interest-rate markets are currently pricing in a first hike in 2024 at the earliest. We target 1.24 for EUR / USD over a 12-month horizon, which is close to the cross rate's fair value. The Swiss franc should benefit from a euro recovery due to the country's close economic ties with the euro zone. We see USD / CHF falling to 0.86 over 12 month, and EUR / CHF to remain in a 1.04–1.10 range.

Our outlook for a global synchronized recovery – the stimulus created by central banks and governments earlier this year is arriving in the economy – argues for European currencies like the euro and the Swedish krona as well as the Australian and the New Zealand dollar. The "aussie" and the "kiwi" benefit from robust economic growth rates in Asia, particularly China, the premier destination of Australian (40 % of total exports) and New Zealand (27 %) goods and services. While the region remains volatile due to China's assertive stance in the South Chinese Sea, for example, we think the danger of an escalation is still relatively limited.

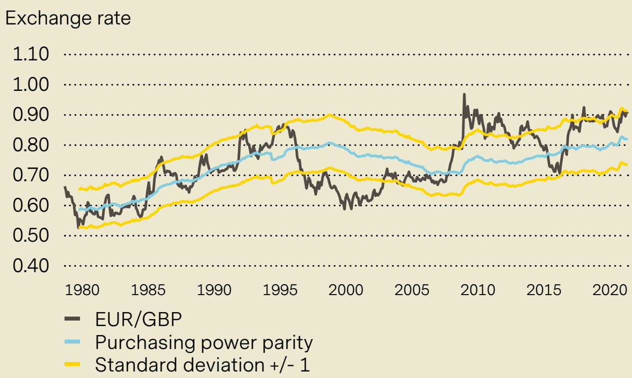
**The pound has priced in negative Brexit prospects**
For all the possible negative repercussions of a major spat between the UK and the European Union over Brexit, we believe that a lot of the negative news is already priced into the currency markets. Despite its significant strengthening in October, the pound still trades at a low level – 10% below what our valuation models (see chart 2) or interest-rate differentials to other markets suggest – and may continue to gain ground versus the euro and the US dollar. Moreover, reading between the lines of politicians' comments, we believe a London-Brussels compromise is still possible. Therefore, we wouldn't be surprised if the pound extended its recent rally.

**Chart 1: Bond yield differentials suggest the euro may gain strength versus the US dollar**




Source: Refinitiv Datastream, Vontobel

**Chart 2: Pound sterling appears to be undervalued**




Source: Refinitiv Datastream, Vontobel

# Economy and financial markets 2018 – 2021

The following list shows the actual values, exchange rates and prices from 2018 to 2019 and our forecasts for 2019 and 2020 for gross domestic product (GDP), inflation / inflationary expectations, key central bank interest rates, ten-year government bonds, exchange rates and commodities.

| GDP (IN %) | 2018 | 2019 | CURRENT | FORECAST 2020 | FORECAST 2021 |
|---|---|---|---|---|---|
| Euro zone | 1.9 | 1.3 | –14.8 | –7.3 | 5.2 |
| US | 3.0 | 2.2 | –9.0 | –4.8 | 3.2 |
| Japan | 0.3 | 0.7 | –10.1 | –5.3 | 2.3 |
| United Kingdom | 1.3 | 1.3 | –21.5 | –8.4 | 6.3 |
| Switzerland | 3.0 | 1.1 | –8.3 | –4.7 | 4.3 |
| China | 6.8 | 6.1 | 4.9 | 1.8 | 8.4 |
| **INFLATION (IN %)** | | | | | |
| Euro zone | 1.8 | 1.2 | –0.3 | 0.3 | 1.1 |
| US | 2.4 | 1.8 | 1.4 | 1.1 | 1.9 |
| Japan | 1.0 | 0.5 | 0.1 | 0.0 | 0.1 |
| United Kingdom | 2.5 | 1.8 | 0.2 | 0.8 | 1.5 |
| Switzerland | 0.9 | 0.4 | –0.8 | –0.6 | 0.5 |
| China | 2.1 | 2.9 | 4.5 | 2.5 | 2.0 |

| KEY INTEREST RATES (IN %) | 2018 | 2019 | CURRENT | FORECAST 3 MONTHS | FORECAST 12 MONTHS |
|---|---|---|---|---|---|
| EUR | –0.40 | –0.50 | –0.50 | –0.50 | –0.50 |
| USD | 2.50 | 1.75 | 0.25 | 0.25 | 0.25 |
| JPY | –0.10 | –0.10 | –0.10 | –0.10 | –0.10 |
| GBP | 0.75 | 0.75 | 0.10 | 0.10 | 0.10 |
| CHF | –0.71 | –0.69 | –0.75 | –0.75 | –0.75 |
| AUD | 1.50 | 0.75 | 0.25 | 0.25 | 0.25 |
| CNY | 4.35 | 4.35 | 4.35 | 4.35 | 4.35 |
| **10-YEAR GOVERNMENT-BOND YIELD (IN %)** | | | | | |
| EUR (Germany) | 0.2 | –0.2 | –0.6 | –0.5 | –0.3 |
| USD | 2.7 | 1.9 | 0.7 | 0.7 | 1.0 |
| JPY | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| GBP | 1.3 | 0.8 | 0.2 | 0.2 | 0.6 |
| CHF | –0.2 | –0.5 | –0.5 | –0.5 | –0.5 |
| AUD | 2.3 | 1.4 | 0.7 | 0.9 | 1.0 |
| **EXCHANGE RATES** | | | | | |
| CHF per EUR | 1.13 | 1.09 | 1.07 | 1.10 | 1.07 |
| CHF per USD | 0.99 | 0.97 | 0.91 | 0.92 | 0.86 |
| CHF per 100 JPY | 0.90 | 0.89 | 0.87 | 0.86 | 0.82 |
| CHF per GBP | 1.26 | 1.28 | 1.18 | 1.24 | 1.24 |
| CHF per AUD | 0.69 | 0.68 | 0.65 | 0.66 | 0.64 |
| USD per EUR | 1.14 | 1.12 | 1.17 | 1.20 | 1.24 |
| JPY per USD | 110 | 109 | 105 | 107 | 105 |
| USD per AUD | 0.70 | 0.70 | 0.71 | 0.72 | 0.74 |
| CNY per USD | 6.95 | 6.51 | 6.86 | 6.70 | 6.75 |
| **COMMODITIES** | | | | | |
| Crude oil (Brent, USD/barrel) | 53 | 66 | 43 | 50 | 55 |
| Gold (USD/troy ounce) | 1281 | 1521 | 1903 | 2000 | 2000 |
| Copper (USD/metric ton) | 5949 | 6149 | 6724 | 7000 | 7000 |

Source: Thomson Reuters Datastream, Vontobel; closing prices for all data: 16.10.2020, forecasts as of 22.10.2020

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